Bloomberg BNA

Daily Report for Executives™

Communications

Comcast-Time Warner Merger

While the public record of the FCC and Justice Department reviews of the Comcast-Time Warner Cable proposed merger could give the impression that competition concerns are manageable and that most stakeholders are supportive, the impression would be wrong, author Martyn Roetter of MFR Consulting writes.

Opponents of the merger could have better presented their objections (and should do so in the time remaining) and some of them have feared to speak out publicly, but the case against the merger is nonetheless clear, he says, and provides an outline of the ''insurmountable defects'' that will cause the regulators to reject the merger.

Why the Comcast-Time Warner Cable Merger Will Fail

BY MARTYN ROETTER, D. PHIL.

The proposed Comcast-Time Warner Cable merger will be rejected, despite Comcast's intense and expensive lobbying efforts.[1] Even the fragmented, uncoordinated and incomplete evidence and analyses presented so far by opponents reveal insurmountable defects. Moreover, the regulatory decision makers understand why some key players are fearful of publicly expressing their objections to the actions of large broadband operators.[2]

The arguments presented to the Federal Communications Commission (FCC) and the Department of Justice (DOJ) in favor of approval of this proposed merger fall into two main categories:

First, it is asserted that this merger will not have any competitive consequences since, with minor exceptions that will be eliminated through a related transaction with Charter Communications, the areas of operation of the two cable operators' franchises do not overlap.[3]

Second, it is asserted that consummation of the transaction will yield significant benefits to customers that cannot be achieved through any other means.

Martyn Roetter, D. Phil., *is a management consultant and adviser to high technology business executives, regulators and investors on matters involving products, markets, competitors, sales channels, and technology. He has extensive business experience in Europe, the Americas, Asia and Africa. He has over 30 years of consulting experience with various companies as well as his own firm—MFR Consulting. He is also associated as a Senior Adviser with the South Africa-based BMI-TechKnowledge (see for example http://www.bmi-t.co.za/?q=content/bmi-t-navigator). He can be reached at +1 617 216 1988 or mroetter@gmail.com.*

[1] http://bgr.com/2014/05/23/comcast-twc-merger-lobbying/.

[2] http://www.dslreports.com/shownews/Comcast-Insulted-By-Concerns-Over-Their-Funding-of-FCC-Dinner-130048; http://www.buzzfeed.com/peterlauria/the-absent-voices-in-the-room#24r3619.

[3] This argument has become a mantra of Comcast for justification of its acquisition of TWC since it was announced.

Substantial Market Failures Are Foreseeable. Both justifications for approving this transaction are weak. Substantial market failures are foreseeable. They will be based on the exercise by a combined Comcast/TWC of a formidable and rare mix of monopoly and monopsony power, coupled with the negotiating advantages of asymmetric information.[4] This enhanced new entity will be operating in a demonstrably uncompetitive market, following Comcast's well-established playbook. These market failures will generate substantial and lasting adverse consequences for customers, innovation, and the public interest.

The claimed benefits of the merger are not verifiable. Nor are they credible.

Furthermore, the claims of the benefits that this combined entity allegedly will generate are not verifiable. Nor are they credible, in light of Comcast's persistent record of indifference to customer care and customers' desires, and its record over many years of substantial discretionary allocations of its ample financial resources for purposes that have nothing to do with improving the experiences and value it delivers to customers.

These benefits could be achieved in the current configuration of broadband and MVPD (Multichannel Video Programming Distributors) without the threats to the public interest posed by a combined Comcast/TWC. Moreover, the size and impact of this transaction, if approved, would create an irresistible precedent for authorizing any other proposed mergers (including AT&T/DirecTV),[5] whether horizontally between broadband operators, or vertically between large broadband operators and content and broadband-delivered services and applications providers.

Big Choice for Competition Policy. The decision of the FCC--and the DOJ--whether to approve the Comcast/TWC merger will send an unmistakable signal about the Commission's directions and strategy under its new Chairman. Denial of Comcast/TWC will demonstrate that the Commission is embarking on a different path from its predecessors. Denial would establish that the Commission is committed to encouraging genuine competition and safeguarding the rights of consumers, as well as the legitimate interests of small and rural players and innovators and the value they deliver to significant segments of the customer base that are neglected by large national operators. In contrast approval, even with conditions (which experience tells us have minimal effect on subsequent behavior), would confirm fears that the Commission lacks the will to restrain the actions and behavior of the broadband oligopoly.

The case for denying the Comcast/TWC merger outlined here does not appeal to only one side of the prevalent partisan political divide.

The debate about the Comcast/TWC deal is inevitably political and does not only involve legal, technical, and economic arguments. Therefore, it is significant that the case for denying the Comcast/TWC merger outlined here does not appeal to only one side of the prevalent partisan political divide in this country. The opposing evidence and analyses are supportive of the interests of rural as well as urban and suburban customers and voters. They also apply to the interests of small and medium municipalities in numerous states—red, blue and purple—as well as of many businesses and institutions, whose effectiveness and efficiency are increasingly dependent on access to competitively priced, high performance broadband channels that are in danger of becoming choke points dominated by a handful of providers.

Assessment of Consequences of the Deal

Approval of the proposed Comcast/TWC merger would not give Comcast *qualitatively* any more or even new ways to abuse its power than are currently available. Nevertheless, *quantitatively* the merger would have competitive consequences. A combined Comcast/TWC would have increased scope and effectiveness compared to today's Comcast for exercising its power, thanks to the increased size of its national customer base to which video programmers, third party or OTT (over-the-top) providers need access via the broadband channels it operates (both cable and Internet access). In addition, device vendors would become more heavily dependent on securing favorable relationships with Comcast/TWC that, according to Comcast's traditional practices, would supply the vast majority of devices that its customers require to connect to its cable channels.

Consequently, there are three sources of market failure that apply to an assessment of the impact of the Comcast/TWC merger:

- Abuses of monopoly or dominant market power (seller side), with respect to the provision to customers of fixed broadband access services and devices for access to video programming;
- Abuses of monopsony or dominant market power (buyer side) with respect to the acquisition of video programming and other broadband-delivered applications and services from third parties as well as devices for delivery to customers;
- Risks of moral hazard and/or adverse selection through the exploitation of asymmetric, i.e., greater information in the possession of Comcast/

[4] There is a considerable body of economic literature on the harm and other consequences flowing from transactions reached under conditions of asymmetric information - see e.g., http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2001/press.html.

[5] The reverse is not true, i.e. approval of the AT&T/DirecTV transaction that would play a smaller role than Comcast/TWC (although significant) in video-capable broadband and video programming and delivery services in the U.S. market would not necessarily justify approval of Comcast/TWC (the question of whether AT&T/DirecTV will or should be approved is not addressed here).

   ISSN 0148-8155

TWC in negotiations with local cable franchising authorities and small broadband operators.[6]

In addition, the validity of Comcast/TWC's claims of the benefits that this transaction would generate should be assessed against three criteria, to determine whether they are:

- Merger-specific, i.e., not otherwise achievable;
- Verifiable;
- Sufficient to offset expected or proven anti-competitive effects of the merger.

The quality and effectiveness of the opposition to Comcast/TWC can be judged in terms of its success in demonstrating the increased risk and providing evidence of market failures from the sources delineated above that will ensue from a Comcast/TWC merger, and exposing the speciousness of Comcast's claims of transaction-related benefits.

Opposition to Comcast/TWC

Review of the Petitions to Deny submitted in the FCC's Docket 14-57 on this transaction reveals that:

(1) A wide range of diverse interests, including network operators, consumer and public interest groups, individual customers, programmers, video distributors, and cable franchising authorities has expressed opposition to the transaction between Comcast, TWC and Charter.

(2) However, the strength of opposition to the merger has been obscured by the fragmented and uncoordinated overall quality of the formal petitions to deny that have been submitted to regulators. Individual petitions focus predominantly on the specific interests (or their charters in the case of public interest groups) of the petitioners. The arguments of underfunded public interest groups do not adequately reflect sector-specific technological and market expertise and experience. Objections by opponents from industry, in addition to significant gaps in their ranks, have not been formulated with the breadth and objectivity to definitively counter Comcast's rebuttals that they are merely defending their interests as competitors and not the public interest and the intrinsic merits of competition. Furthermore, there is little exposition of recommendations for alternative futures to the one inherent in approval of the Comcast/TWC transaction to help the Commission develop positive ideas to accompany its denial.

(3) As a result of this fragmentation and lack of coordination, the petitions have been vulnerable to rebuttal from Comcast along the lines enunciated by Comcast's Executive Vice President David Cohen.[7] He argues that every opponent of the transaction is only pursuing its own narrow self-serving interests. This characterization reduces the various presentations in favor of and against the Comcast/TWC transaction to conflicting ''he said, she said'' versions of ''we are acting in the public interest and the others are not,'' and ''the transaction will deliver benefits'' versus ''no, it will not,'' buttressed by opposing legal interpretations of applicable laws and regulations and economic sophistry that are supported by a cast of academics, consultants and lawyers, including antithetical declarations from impressively credentialed experts. In such a murky debate it is hard to perceive otherwise widely and easily understandable distinctions between the respective merits and flaws of the pro- and anti-transaction camps.

(4) Furthermore, it is remarkable, and from the perspective of opponents to the Comcast/TWC merger, disturbing, that with the exception of Netflix the petitioners include no major Web company. Yet the role of Comcast/TWC in providing Internet access in the U.S. is considerable, so the concerns expressed in the Open Internet Proceeding (14-28) are directly relevant to Docket 14-57. This absence is a significant gap that weakens the impact of the opposition and allows Comcast to claim that its promise to adhere to the FCC's Net Neutrality conditions should dispel any fears that it will abuse its market power in this crucial context.

Nevertheless, there are several strong points validated by solid verifiable evidence and analysis that can be gleaned from combining the petitions to deny, including:

- The U.S. market for fixed broadband services capable of handling video streaming (the major source of broadband traffic today) is uncompetitive since many customers are served by only two providers or even just one (see Figure below);
- Wireless broadband services are not effective or reasonable substitutes for fixed broadband services for the great majority of customers, nor can they ever be;[8]
- Comcast and *a fortiori* Comcast/TWC has substantial market power, with potential for abuse through more than one ''choke point,'' including (but not limited to) last mile access and the interconnection point to last mile access;
- Surveys and many individual customers find and have found Comcast's customer service to be unresponsive and of appalling quality;
- Independent programmers have experienced significant difficulties in obtaining fair and reasonable access to Comcast's customers;
- Threats from discriminatory interconnection agreements established by Comcast are worthy of attention.

[6] *Adverse selection:* Inability of one party in a transaction to distinguish among products of different quality resulting in a bias towards its acceptance of low quality products; *Moral hazard:* A situation in which one party is able to take actions after a transaction has taken place to the detriment of the other party.

[7] http://corporate.comcast.com/comcast-voices/comments-on-comcast-time-warner-cable-transaction-due-today-at-fcc.

[8] The claim or strong implication by Comcast and other major broadband operators that the presence of four or more mobile services providers in local markets makes the U.S. broadband market effectively competitive is therefore specious.

However, there are notable omissions and gaps in opponents' evidence and arguments that must and can be filled to build a more thorough and less vulnerable case for denial of the Comcast/TWC transaction including:

- Financial analysis to demonstrate that Comcast has consistently preferred to allocate substantial amounts of the ample financial resources generated by its business, that for the most part come from its exploitation of local monopoly franchises, for the predominant benefit of a handful of individuals responsible for these allocations, and not as it claims for the benefit of customers or other stakeholders (e.g., via share buybacks);
- Establishment of a comprehensive and seamless depiction of all the ''choke points'' at Comcast/TWC's disposal (there are four) that fundamentally differentiate its power from that of other players (not network operators) within the overall Internet (or more broadly CAS (Content, Applications, and Services)) value chain. This asymmetry of power in favor of Comcast/TWC even applies to organizations it deals with that in terms of total revenues are larger than a combined Comcast/TWC;
- Delineation of the inevitable deleterious consequences of approval of the Comcast/TWC transaction for the future of competition in the U.S. broadband market and innovation throughout the economy;
- Depiction of alternative effective regulatory scenarios for the U.S. that reflect a higher priority for the interests of consumers and the stimulation of innovation than the one inherent in and substantially reinforced by approval of the Comcast/TWC transaction; and
- Thoughtful future-oriented discussion of likely market and technological developments that are directly relevant to the review and identification of the foreseeable consequences of the Comcast/TWC transaction but have been largely ignored so far, e.g.,
  - o Expanding range of agreements between cable operators aimed at eventual national coverage of their Wi-Fi hotspots supplemented by cellular network,[9]
  - o Prospects for the Internet of Things (IoT) or M2M (machine-to-machine) communications, and hence the spreading tentacles of a broadband oligopoly throughout the economy, [10] and
  - o Trends in video advertising.[11]

Comcast/TWC: A Further Erosion of Already Inadequate Competition

In the wireless services sector both the FCC and DOJ expressed grave reservations in the context of the heavily rumored, now publicly abandoned, proposal for a merger between T-Mobile and Sprint about whether three players would be sufficient to sustain effective competition in a national network market.[12] In this view four competitors is the minimum number required for a market to be considered effectively competitive.

[9] http://www.cablewifi.com/.

[10] See for example, http://www.gsma.com/connectedliving/wp-content/uploads/2014/08/cl_iot_wp_07_14.pdf.

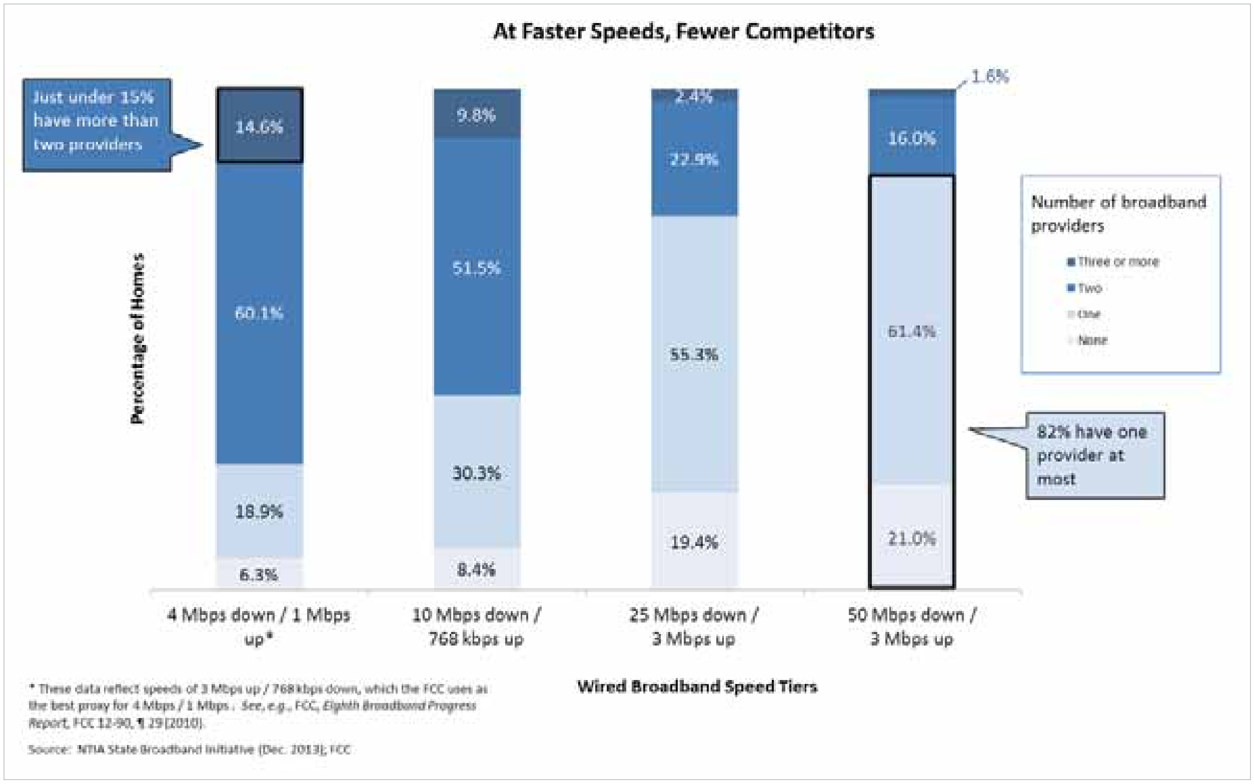
[11] See for example, http://www.adexchanger.com/digital-tv/the-video-ecosystem-ooyala-on-the-cloud-consolidation-and-tvs-digital-future/.

[12] http://www.fiercewireless.com/story/analysts-sprintt-mobile-deal-would-face-uphill-battle-regulators/2013-12-17.

But at the local level where decisions are made for subscriptions to fixed broadband access many U.S. customers do not even have a choice between three broadband providers. They are limited as noted to only two, or even just one supplier of video-capable broadband access services. The absence of effective competition in fixed broadband access services is by itself sufficient grounds for denying the Comcast/TWC transaction. While consolidation of Comcast/TWC would not reduce the current number of video-capable broadband access providers available to customers below the two or no alternatives in many areas or in some subdivisions or enclaves within them, it would nevertheless increase the power of the combined entity at both national and regional levels.

The absence of effective competition in fixed broadband access services is by itself sufficient grounds for denying the Comcast/TWC transaction.

Several regional markets in the U.S., as defined by Rand McNally's trading areas, comprise multiple local areas that are currently served by cable providers with different owners. If the transaction is consummated these regions would then be served exclusively or pre-



dominantly by cable franchisees with the same corporate parent (e.g. Comcast/TWC in Los Angeles).

The combined entity would enjoy increased power in negotiations (monopsony power) with providers of national and regional programming, content and services for their conditions of access to and use of broadband channels connected to large and influential concentrations of U.S. customers (consumers, businesses, and institutions). It would also be able to exploit its greater influence over the delivery of content and services popular with residents of cable franchise areas and its asymmetric command of information in establishing the terms of typically monopoly franchise agreements with local cable authorities. These authorities include small and medium municipalities with limited resources and expertise to resist or even to understand the implications and consequences of Comcast's demands and proposed conditions.

Ensuring Rejection of Deal

Comcast is dependent on privileged access to and use of scarce public resources and assets in its franchises that should be exploited without unreasonable discrimination for the benefit of all. They should not be limited to those segments of the market Comcast finds to be most attractive for its own purposes. Regulators' attention to this perspective will support denial of the proposed Comcast/TWC transaction.

Nevertheless, the many and diverse opponents of the merger would be well advised to coordinate and fully expound all the reasons enumerated above to ensure that the compelling case against the creation of a formidable combination of monopoly and monopsony power emerges clearly. Comcast/TWC would control a substantial proportion of infrastructure essential to the future of a 21st century economy and society.

Even if leadership at the Commission is inclined to reject the Comcast/TWC transaction on competitive grounds,[13] the opposition would be wise to make sure the regulators understand the issues and the enormity of the stakes involved, and appreciate that there is far more support for rejecting the merger than may be audible against the incessant din of lobbying and propaganda they are hearing from Comcast. They must reinforce and ''connect the dots'' in the evidence and analyses to make the denial incontestable in the face of the intense well-funded pressure being exerted by Comcast and its advocates and fellow travelers in industry, politics, academia, and think tanks.

[13] http://www.lightwaveonline.com/articles/2014/09/fcc-chairman-wheeler-finds-broadband-competition-lacking.html?cmpid=EnlfttxSeptember102014.